

**EXAMINATION OF
SELECTED TRANSACTIONS
AND ACTIVITIES OF THE
KENTUCKY RACING COMMISSION**



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EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

August 5, 2003

Frank Shoop, Chairman
Kentucky Racing Commission
4063 Iron Works Pike, Building B
Lexington, Kentucky 40511

Dear Chairman Shoop:

In response to a citizen's complaint, our office initiated an examination of selected issues concerning the Kentucky Racing Commission (Racing Commission). As a result of our initial inquiries and the receipt of further citizens' concerns, the scope of our examination expanded into other areas.

Our examination focused primarily on activities of the Backside Improvement Commission (Backside Commission) and the Backside Improvement Fund. We also examined the purchase and distribution of Racing Commission pins and passes, the Commissioners Special Account, and procedures involving claims at thoroughbred race tracks.

Our procedures included interviews with Commissioners, Racing and Backside Commission staff, officials in the Public Protection and Regulation Cabinet, and other state employees. We also analyzed financial data and related correspondence of the Racing Commission and other documents.

This report includes our findings and recommendations. We have also referenced a review by the Finance and Administration Cabinet concerning a proposed contract for equine drug research. We wish to thank you, the Racing Commission staff, and others for cooperating during this examination.

Very truly yours,

Edward B. Hatchett, Jr.
Auditor of Public Accounts

EBHJr:kct



Introduction and Background

The Auditor of Public Accounts examined transactions and activities of the Backside Improvement Fund (Fund) for the period July 1, 1999, through May 31, 2003. The examination resulted from a citizen's concern that the Fund's expenditures did not comply with its governing statute. The complaint alleged that two security employees were hired as principal assistants by the Kentucky Racing Commission (Racing Commission) but were paid by the Fund.

We analyzed the transfers of moneys between the Racing Commission and the Fund. We also examined the role of the position of Executive Director of the Backside Improvement Commission (Backside Commission), and ascertained the personnel cost attributable to the position.

Additional matters were brought to our attention, broadening our examination into other areas of the Racing Commission. These areas included the purchase and distribution of pins and passes, the Commissioners Special Account, and claiming procedures at the thoroughbred tracks.

The Backside Commission and the Fund were created by the General Assembly in 1980. The Backside Commission consists of four appointed members who serve without compensation.

The purpose of the Fund, as stated by KRS 230.218(4), is "to improve the backside of thoroughbred racing associations averaging \$1,200,000 or less pari-mutuel handle per racing day on live racing." The Backside Commission, under the general jurisdiction of the Racing Commission, is charged with using the Fund "to promote, enhance, and improve the conditions of the backside of eligible racing associations." The tracks that benefit from the Fund are Turfway Park in Florence and Ellis Park in Henderson. These tracks contribute to the Fund an amount equal to one-half of one percent of their on-track pari-mutuel wagers.

The Backside Commission's governing administrative regulation, 810 KAR 1:021, states "[a]ll monies disbursed by the Backside Improvement Commission shall be used solely for improvements to backside facilities," defined as "those facilities located at thoroughbred horse racing tracks which serve the primary function of stabling and quartering of horses and where stable employees work and live." KRS 230.218 allows the Backside Commission to employ qualified personnel as necessary and determine their compensation. Personnel costs and other necessary operating expenses may be paid out of the Fund.

Findings and Recommendations

Cost of Executive Director is an unnecessary expense for the Backside Commission.

Although the statute allows the Backside Commission to hire necessary personnel, there is no explicit provision for an Executive Director. As a result of our examination, we conclude that the duties of directing the Backside Commission are insufficient to warrant a full-time employee or Executive Director.

*The Backside Commission
has not met since
November 2001.*

The Backside Commission is required by regulation to meet annually to consider applications and to approve funding of the projects it deems justified. The Backside Commission actually meets when new projects are proposed or to discuss existing projects. The Backside Commission met in April, July, and November 2001. The Backside Commission did not meet in 2002 and has not met in 2003.

*Backside Commission
typically oversees six or
fewer annual transactions
with eligible racing
associations.*

For the last several years, the Backside Commission has returned to the tracks amounts approximating the sums contributed by each track. Since the fall meeting of 1999, Ellis Park has paid \$238,985 to the Fund and has received checks from the Fund totaling \$239,190. Since January of 1997, Turfway Park has paid \$604,912 to the Fund and received \$605,114. Typically, Ellis Park makes one remittance each year after its summer meeting and receives one check from the Fund. Turfway Park makes remittances to the Fund for each of its three separate race meetings, but typically receives just one check per year from the Fund.

The Fund had a balance of \$229,160 in the state's accounting system at May 31, 2003. The Fund earns interest on its account balance, which supplements the contributions received from the tracks. Other than payroll and project payments to the tracks, expenses of the Fund are meager.

*Current Backside
Commission Executive
Director's initial salary
was 76 percent greater than
that of her predecessor.*

The current Executive Director of the Backside Commission was appointed on September 16, 2000, from another non-merit position in the Racing Commission. She received a five percent increase in salary from that in her previous position to \$59,088 annually. This salary represents an increase of 76 percent from the Backside Commission's previous Executive Director's annual salary of \$33,492.

The Executive Director's leave balances were depleted and she charged over 2,000 hours to leave-without-pay over the last four years. The Racing Commission deemed the leave to be necessary and gave approval. Accordingly, the Fund has not absorbed her full annual salary. Nonetheless, the actual cost to the Fund for her salary and fringe benefits exceeded \$148,000 from September 2000 through May 2003.

The Executive Director's salary has increased through annual increments to \$66,916 a year. With fringe benefits the annual cost to the Fund for this position is nearly \$80,000, disregarding further leave-without-pay. This cost to the Fund is grossly excessive to direct a commission that in the course of a typical year meets once or twice, receives two or three payments, and issues two checks. While the Fund by statute must pay the necessary expenses of its administration, a full-time Executive Director is not necessary for these minimal duties.

Recommendations

We recommend the Racing Commission, with the approval of the Backside Commission, abolish the Backside Commission Executive Director position and designate a Racing Commission employee to administer the Fund. Only the actual time spent by any Racing Commission employee for Backside Commission tasks should be charged to the Fund. We estimate this would save the Fund at least \$50,000 annually, money that should be used for the Fund's statutory purpose of improving the backsides of these smaller tracks.

The Racing Commission hired two principal assistants through positions established in the Backside Commission.

Since 1999, the Racing Commission appropriated positions established in the Backside Commission to supplement its own staff. An administrative reorganization of the Racing Commission resulted in four positions being reclassified under the Backside Improvement branch within the Racing Commission. In April 2000, two security employees were hired as principal assistants in the Backside Improvement branch. The Racing Commission transferred funds each of the last four years from its racing and administration account to the Fund account to pay the salaries of these employees.

Racing Commission transferred over \$500,000 to the Fund to compensate for principal assistants.

Since July 1999, a net total of \$502,180 has been transferred to the Fund from the Racing Commission's administration account. This total is comprised of net annual transfers to the Fund in fiscal years 2000, 2001, and 2002. The total includes a transfer in August 2002, erroneously directing \$83,000 to the Fund from the Racing Commission's administration account.

From July 1999 through May 2003, salaries and benefits paid from the Fund totaled \$645,073. The amount of salary and benefits attributable to the Fund's Executive Director position totaled \$173,073. Salaries and benefits attributable to other Racing Commission employees paid from the Fund totaled \$472,000. Allowing only for the salary of the Executive Director to be paid from the Fund, an excess of \$30,180 remained in the Fund from the transfers through May 2003.

Recommendations

We recommend the Racing Commission transfer any excess salary money remaining in the Fund at the end of the fiscal year to the appropriate Racing Commission account.

We further recommend the Racing Commission cease funding *de facto* employees through the Fund or any restricted fund.

The purchase and distribution of Racing Commission pins should be restricted; passes should be discontinued.

In March 2003, the Executive Branch Ethics Commission (Ethics Commission) issued Advisory Opinion 03-15 (Exhibit A). This opinion addressed the Racing Commission's long-standing practice of distributing Racing Commission pins that allow free admission to the state's tracks. The Ethics Commission concluded that Racing Commission and certain other state regulatory employees should not accept gratuities attributable to these pins in excess of \$25.

The principal value of a Racing Commission pin, other than as a collectible commemorative item, was free admission to Churchill Downs the pin afforded for the Kentucky Oaks and the Kentucky Derby. This issue became moot this year when the Racing Commission and Churchill Downs jointly decided the pins would not be honored at the Oaks or Derby. The pins are still honored on other racing days.

The Ethics Commission's opinion stated: "it is a clear conflict of interest for the Racing Commission to solicit free admission for pin owners from the tracks, as the Racing Commission closely regulates the tracks...." The administrative regulation concerning racing associations, 810 KAR 1:026, states "an association shall honor for access to preferred parking facilities and other areas on its grounds a commission or Association of Racing Commissioners International ring, lapel button, or automobile emblem." The regulation does not address how many pins should be distributed, or to whom.

By custom, Racing Commission pins were distributed to Commissioners, former Commissioners, Racing Commission staff, the Governor, former Governors, and other dignitaries. According to its Chairman, the Racing Commission decided to issue new pins each year to increase security, because counterfeit pins were being presented at tracks. Approximately 500 pins were ordered in 2001 and 2002; that number decreased to 332 in 2003, according to the supplier's invoice. The Racing Commission provided a list detailing the distribution of 178 pins (Exhibit B). Unless otherwise noted on the list, recipients received two pins each. We verified that the remaining 154 pins were physically on hand at the Racing Commission's office. This provides a full accounting of the 332 pins purchased for 2003.

Racing Commission pins were purchased with both public and private funds.

The Racing Commission spent \$7,946 of state funds for the 2001 pins. The Racing Commission paid for the 2002 pins from the Commissioners Special Account, funded privately by the individual Commissioners, with two checks totaling \$5,698. The 2003 pins, also purchased from the Commissioners Special Account, cost \$4,683.47.

Change in Racing Commission procedure eliminated the need for track admission passes.

Another issue is the Racing Commission's purchase and distribution of free track admission passes. According to the Racing Commission's Executive Director, during the years 1995 through 2000, the Racing Commission issued two passes to each Racing Commission licensee, amounting to some 28,000 passes by the year 2000. The Racing Commission bought and distributed the passes, and was reimbursed for the production costs by the tracks. In 2001, the procedure was changed allowing track admission upon presentation of a Racing Commission license. The Racing Commission still ordered passes, but far fewer than before. In both 2001 and 2002, about 2,500 passes were purchased; by 2003, this number has decreased to 1,000. According to the Racing Commission's Chairman, passes are given to people connected with racing, such as retired backside workers, who express an interest in obtaining one.

The cost of the passes in 2000 was \$12,269, paid from state funds but reimbursed by the tracks. The cost of the 2003 passes was \$649.91, paid from the Commissioners Special Account.

Recommendations

We recommend the Racing Commission reduce the list of persons eligible for a Racing Commission pin to the Commissioners themselves and staff. The pins should afford free track admission only when the pin holder's presence is required for official business. By limiting the use of the pins to official business, it is appropriate for the state account rather than the private Commissioners Special Account to pay for their cost of production.

We recommend the purchase of track passes be discontinued.

Commissioners Special Account should be privately maintained and solely used for private purchases.

In March 2001, the Commissioners opened a separate bank account known as the Commissioners Special Account. The deposits into this checking account are comprised of the *per diem* stipends and expenses paid to the Commissioners for attending meetings. The Commissioners voluntarily contribute this money to the account, which is used frequently to buy flowers and other tokens of memorial for members of the racing community who have died.

The account has also been used to purchase Racing Commission lapel pins and passes, various awards such as julep cups for Derby trainers, and in one instance, a \$1,200 payment to a consultant for his help in evaluating proposals for an equine drug testing contract.

KRS 41.290 states that agencies “having private funds or contributions available for its support or for the purpose of defraying the expenses of any work done under its direction shall deposit such funds or contributions with the Treasurer.... All disbursements from such funds and contributions shall be made by the Treasurer on the warrants of the Finance and Administration Cabinet....”

Although this account is funded privately by the Commissioners’ donated stipends, Racing Commission employees maintain the account, a task that involves handling invoices, writing and distributing checks, and reconciling the checkbook.

We noted three instances in 2002 in which the Racing Commission made purchases through its Commissioners Special Account without paying the applicable six percent sales tax. This account is not an official account of the state and does not represent state funds. It therefore is not eligible to take advantage of the sales tax exemption granted to state agencies. The Racing Commission recently asked for and received corrections for unpaid invoices for pins and passes, in order to ensure proper payment of sales taxes.

Recommendations

We recommend the Racing Commission ensure that the disbursements of the private Commissioners Special Account be limited to tokens of acknowledgment or other concerns of a private, non-official nature.

The use of a private consultant in the request for proposal process appears to be a legitimate public use for Racing Commission funds. We therefore recommend services of this type be paid for by the state, and that the accounting for and approval of procurement of that service be handled and scrutinized like any other state expenditure.

We recommend the Racing Commission not use public resources to maintain the Commissioners Special Account. We further recommend care be exercised to ensure that purchases made through this private account include proper calculation and payment of sales tax.

Racing Commission requires strict adherence to Administrative Regulations over claiming races.

Another concern brought to our attention alleged that Racing Commission stewards improperly rule as invalid claims of horses entered in claiming races. This practice allegedly costs the state thousands of dollars in sales taxes that would otherwise be collected on valid claim sales.

The Racing Commission addressed this issue in a letter to the Administrative Regulation Review Subcommittee (Exhibit C). 810 KAR 1:015 §7(b) states “[t]he ‘Claim Blank’ form and envelope shall be filled out completely and accurately.” In the case of the specific complaint, the stewards judged that the claim envelope did not completely and accurately contain the name of the track. The Racing Commission’s position is that anything less than complete and accurate information on the claim form and envelope would subject the claim to debate should the claimant attempt to renege on the claim.

According to figures cited in the Racing Commission’s letter, about ten percent of claims at Kentucky’s thoroughbred tracks are voided. This amounts to about six voided claims per month. Of the voided claims, a small percentage is due to misspelled or abbreviated track names. Most of the reasons cited for voiding claims appear to be avoidable errors on the part of the claimants.

Recommendations

We recommend the Racing Commission reinforce its efforts to educate potential claimants on the statutory requirements and to assure the availability of assistance from stewards or a clerk of claims.

We further recommend that the Racing Commission revise the claim form to lessen the possibility of voids due to inadvertent spelling errors. All tracks could be listed for the claimant to check off the applicable track. Also the requirement of inserting a sales tax percentage could be eliminated with wording that refers to “plus all applicable Kentucky Sales Tax.”

Proposed Racing Commission personal service contract found deficient by the Finance and Administration Cabinet.

At the request of the Auditor of Public Accounts, the Finance and Administration Cabinet (FAC) examined allegations concerning a proposed personal service contract between the Racing Commission and Richard A. Sams, DVM. The Racing Commission had sought an exemption from the state procurement process to facilitate the acquisition of expertise necessary to oversee equine drug research.

Secretary Gordon C. Duke communicated the conclusions and recommendations of FAC's review to the APA on April 1, 2003. His communication is included in this report (Exhibit D).

The proposed contract with Dr. Sams was not approved or implemented. FAC concluded that the Racing Commission had not developed a sufficiently clear description of the service and work products required to determine whether state personnel, including state universities, could meet the need. If inquiries determined that state personnel could not perform the required services, a request for proposals should be developed and advertised widely enough to ensure the opportunity for potentially competent providers to participate.

EXHIBITS

EXHIBIT A

Executive Branch Ethics Commission

ADVISORY OPINION 03-15

March 25, 2003

RE: Kentucky Racing Commission Pins

This opinion is issued by the Executive Branch Ethics Commission (the "Commission") upon its own motion. This matter was reviewed at the March 25, 2003, meeting of the Commission and the following opinion is issued.

The Commission has recently become aware of a long-standing practice by the Kentucky Racing Commission ("Racing Commission") of handing out several hundred "racing commission" pins to individuals which allow them free admission to state tracks, and access to privileged areas at the Derby, such as millionaire's row. Information available to the Commission asserts that the individual tracks decide what privileges those awarded the pins will receive. In the past, the pins have been provided to former governors, former Racing Commission members, Racing Commission office staff, cabinet secretaries, employees of the governor's office, and other politically connected individuals.

The pins are paid for out of a pool of stipend monies that is composed of stipends donated by the Racing Commission members.

The Commission views this practice by the Racing Commission in light of KRS 11A.005(1)(c) and KRS 11A.020(1)(d), which provide:

(1) It is the public policy of this Commonwealth that a public servant shall work for the benefit of the people of the Commonwealth. The principles of ethical behavior contained in this chapter recognize that public office is a public trust and that the proper operation of democratic government requires that:

...

(c) A public servant not use public office to obtain private benefits; and

(1) No public servant, by himself or through others, shall knowingly:

...

(d) Use or attempt to use his official position to secure or create privileges, exemptions, advantages, or treatment for himself or others in derogation of the public interest at large.

The practice of the Racing Commission providing these pins to individuals to allow the individuals free admission and access to privileged areas of tracks obviously puts pressure on tracks to allow such gratuities. It is a clear conflict of interest for the Racing Commission to

solicit free admission for pin owners from the tracks, as the Racing Commission closely regulates the tracks, and the tracks would undoubtedly feel pressure to comply with the "request." Even if the Racing Commission members or staff do not directly solicit the tracks for such gratuities, the awarding of the pins to individuals certainly suggests, based on past practice, that the Racing Commission requests such. If a track decided not to allow free admission based on pin ownership, clearly the Racing Commission members and staff involved in regulating the track would be aware of such a decision.

While the Racing Commission members themselves are not subject to the Executive Branch Code of Ethics (the "Code"), the Racing Commission staff is, and the members of the Racing Commission should consider the negative impact such a practice has on public confidence in the integrity of state government. The Commission previously has issued advisory opinions that address the propriety of solicitation of vendors or regulated entities by state agencies, and the obligation an entity may feel because to the source of the solicitation. See Advisory Opinions 98-13 and 94-70.

Furthermore, any perceived public benefit of the distribution of pins is outweighed by the need to uphold the public trust in the independence of government.

The Commission is concerned, also, about the propriety of distributing many of the pins to Racing Commission office staff and other previously noted state government officials. These state employees are subject to the Code, and specifically the gifts prohibition at KRS 11A.045(1) which states:

(1) No public servant, his spouse, or dependent child knowingly shall accept any gifts or gratuities, including travel expenses, meals, alcoholic beverages, and honoraria, totaling a value greater than twenty-five dollars (\$25) in a single calendar year from any person or business that does business with, is regulated by, is seeking grants from, is involved in litigation against, or is lobbying or attempting to influence the actions of the agency in which the public servant is employed or which he supervises, or from any group or association which has as its primary purpose the representation of those persons or businesses. Nothing contained in this subsection shall prohibit the commission from authorizing exceptions to this subsection where such exemption would not create an appearance of impropriety.

Though the pins are paid for by Racing Commission members, the true benefit of the pins isn't the pins themselves, but the free admission to tracks that the pins provide (and apparently access to all areas of the tracks), and these benefits are paid for by the tracks. As Racing Commission staff and certain other state officials who work for agencies that regulate the tracks, they should not accept gratuities provided by the pins that exceed the allowable amount set forth above in KRS 11A.045(1). If an employee has an official purpose to be at the track, then obviously the track may allow the employee access to the track areas needed to fulfill official duties, without the need of a pin. However, as "perks" of the job, the gratuities provided by the pins in excess of the amount stated above are prohibited by the Code.

Enclosures: Advisory Opinions 98-13 and 94-70

EXHIBIT B

2003 Kentucky Racing Commission Pins

| | | | |
|-------------|------------------|--|----|
| Amos | Penny | | 1 |
| Asbury | John | | 2 |
| Baker | Ben | | 3 |
| Beam | Bill | | 4 |
| Bowie | Sam | | 5 |
| Bowman | Carl | | 6 |
| Branham | Still | | 7 |
| Breathitt | Gov Ned | | 8 |
| Broadbent | Martha | | 9 |
| Bromagen | Glen | | 10 |
| Brown, Jr. | Gov. John Y | | 11 |
| Cain | Jim | | 12 |
| Carlisle | Wayne | | 13 |
| Carrol | Gov Julian | | 14 |
| Caudill | Burnis | | 15 |
| Chandler | Alice | | 16 |
| Colley | Ted | | 17 |
| Collins | Gov Martha Layne | | 18 |
| Combs | Brownell | | 19 |
| Davis | Nancy | | 20 |
| Davis | Bob | | 21 |
| Dehart | William | | 22 |
| Dixon | Shirley | | 23 |
| Durr | R.C. | | 24 |
| Farmer | Tracy | | 25 |
| Fields, Jr. | Lon E. | | 26 |
| Fisher | Mitzi | | 27 |
| Fisher, Jr. | Dr. V.L. | | 28 |
| Ford | Gov Wendell | | 29 |
| Ford | Ed | | 30 |
| Galloway | Maurice | | 31 |
| Gentry | Tom | | 32 |
| Godman | Lee | | 33 |
| Grayson | Merwin | | 34 |
| Green | Curtis | | 35 |
| Greene | Robert L. | | 36 |
| Guilfoil | Marc | | 37 |
| Hancock | Arthur B. | | 38 |
| Hausman | Marty | | 39 |
| Herbstreit | Jackie | | 40 |
| Holtz | Charles | | 41 |

| | | | |
|-----------------|--------------|-------|-----|
| Hudson | Greg | | 42 |
| Jones | Gov Brereton | | 43 |
| Jones | John T.L. | | 44 |
| Jones | W. Lynn | | 45 |
| Kelly | Connie | | 46 |
| Klein | Richard B. | | 47 |
| Koenig | Trudy | | 48 |
| Lavin | Elizabeth | | 49 |
| Lyster | Wayne | | 50 |
| Madden | Anita | | 51 |
| Martin | Sarah | | 52 |
| Martin | Andrew | | 53 |
| Mendoza | Victor | | 54 |
| Miller | Sec. Janie | | 55 |
| Moloney | Donna | | 56 |
| Nuckols Jr. | Charles | | 57 |
| Partlow | Barbara Tway | | 58 |
| Patterson | Margaret | | 59 |
| Planter | Ken | | 60 |
| Robke | Jim | | 61 |
| Rouse | William | | 62 |
| Rudd | Mason C. | | 63 |
| Schipke | Roger | | 64 |
| Scully | Clara | | 65 |
| Sholar | Nate | | 66 |
| Shumate | C. Wayne | | 67 |
| Sights | Dale | | 68 |
| Slayback | Alan | | 69 |
| Squires | James | | 70 |
| Stallings | Robert G. | | 71 |
| Steele | Robert | | 72 |
| Stewart | Kim | | 73 |
| Sturgill | William B. | | 74 |
| Sullivan | William | | 75 |
| Taylor | Smitty | | 76 |
| Thompson | Kendra | | 77 |
| Thornton | Jim | | 78 |
| Todd | Bambi | | 79 |
| Vest | William | | 80 |
| Ward | John T. | | 81 |
| Wilson | Melvin | | 82 |
| | | | |
| | | Total | 164 |
| Churchill downs | | 1 | |
| Keeneland | | 1 | |

| | | | |
|---------------------|------------|-------|----|
| | | | |
| Special pins | | | |
| Patton | Paul | | |
| Patton | Judi | | |
| Shoop | Frank | 4 | |
| Jones, Jr. | Frank | | |
| Hettel | Bernard J. | | |
| | | Total | 12 |

Grand total of all pins distributed
178

Total pins NOT distributed
154

Total of pins ordered for 2003
332

EXHIBIT C



PAUL E. PATTON
Governor
C. Frank Shoop
Chairman
Frank L. Jones, Jr.
Vice- Chairman
Bernard J. Hettel
Executive Director &
Chief Steward

KENTUCKY RACING COMMISSION

Kentucky Horse Park
4063 Iron Works Parkway
Lexington, Kentucky 40511
Phone (859) 246-2040
FAX NO. (859) 246-2039

MEMBERS
Sam P. Bowie
Wayne E. Carlisle
Alice H. Chandler
Lon E. Fields, Sr.
V. L. Fisher, Jr., M.D.
Richard B. Klein
Barbara Tway Partlow
Nathan Sholar
Robert G. Stallings

June 3, 2003

*Representative John Arnold, Co-Chair
Senator Damon Thayer, Co-Chair
Administrative Regulation Review Subcommittee
Legislative Research Commission
State Capitol, 700 Capital Avenue
Frankfort, Kentucky 40601*

Dear Representative Arnold and Senator Thayer:

From January 1, 2001, to and including June 1, 2003, one thousand six hundred and seventy-four (1,674) claims have been made at Kentucky's thoroughbred tracks. In the aforementioned time frame, one hundred seventy-three (173) claims have been voided. The reasons for voiding a claim varies greatly; here are several: misspellings, incorrect date, horse is scratched, trainer not Authorized Agent for claimant, late, expired temporary license, insufficient funds, no existing horseman's bookkeeper account, use of wrong claim blank or envelope, use of stable names, protection claims, and abbreviation or misspelling of track's name. Twenty-nine (29) of the total number of voided claims was for this last reason. On September 18, 1984, the claiming forms were approved by the Kentucky State Racing Commission. This form was considered to be user friendly, by merely filling in the blank with the required information. It is my belief that both the claim card and envelope has served the Commission well over the ensuing years. I have enclosed one of each for your consideration. Mr. Henry "Cap" Hershey, then Vice-Chairman of the Commission, insisted that the claim card be accurately completed to avoid any debate about the validity of a claim. The Stewards of the Kentucky Racing Commission have maintained that requirement for complete accuracy since then.

With regards to Mr. Tom Callahan's complaint I can only offer that the Stewards and a Clerk of Claims is available to answer any questions about claiming procedure or restrictions anytime during the race day. Had Mr. Callahan sought the



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Page 2

advice or direction regarding claiming, his card would have been completed correctly and his claim honored. To the best of my knowledge, Mr. Callahan did not seek the advice or counsel of anyone during this event, but merely assumed he was competent to complete the form.

The necessity for accurate completion of the required information ends any debate about a claim's validity. Should there be any consideration for something less, given the serious nature of the claiming business, would only encourage debate when a claim becomes a burden, such as a claimed horse breaking down during the race in which he was claimed.

I am available to discuss the contents of this letter with the subcommittee should you desire. Please advise me.

Regards,

*Bernard J. Hettel
Executive Director/Chief Steward*

Enclosures

**Kentucky
Racing Commission**

CLAIM BLANK

Track: _____ Date: _____

(Print name of owner or owners making claim)
DO NOT USE STABLE NAME

hereby claim the horse _____

from the _____ race of this date, for the sum of \$ _____
plus _____ Kentucky Sales Tax. (Funds equal to or in excess of this amount have been credited to my
account with the Horsemen's Bookkeeper.) And certify that this claim is made in accordance with the
provisions of 810 KAR 1:015.

Signature of Owner or
Authorized Agent* _____

***SIGN IN THE SAME MANNER IN WHICH YOU SIGNED YOUR LICENSE APPLICATION.**

CLAIM

_____ TRACK

_____ RACE

TIME

Please Stamp

EXHIBIT D



PAUL E. PATTON
GOVERNOR

OFFICE OF THE SECRETARY
FINANCE AND ADMINISTRATION CABINET
383 CAPITOL ANNEX
FRANKFORT, KENTUCKY 40601
(502) 564-4240
(502) 564-6785 FAX

GORDON C. DUKE
SECRETARY

April 1, 2003

Mr. Edward B. Hatchett, Jr.
Kentucky State Auditor
Auditor of Public Accounts
2501 Georgetown Road
Frankfort, Kentucky 40601

Subject: Proffered Personal Service Contract C-03036568

Dear Auditor Hatchett:

In your March 11, 2003 letter to Representative Brent Yonts, chair of the Government Contract Review Committee, and me, you communicated the receipt of anonymous complaints regarding the subject proposed contract between the Kentucky Racing Commission and Richard A. Sams.

You requested that I take these allegations under advisement and, as reported in my letter to you of March 12, 2003, I instructed our staff to conduct a thorough review of these matters. Their report to me is attached. I have communicated to the Kentucky Racing Commission the recommendations contained therein regarding the proper approach to contracting for these services.

Again, I appreciate you sharing your concerns with this Cabinet.

Sincerely,

A handwritten signature in black ink, appearing to read "Gordon C. Duke".

Gordon C. Duke, Secretary
Finance and Administration Cabinet

Attachment

c: B. Yonts
D. Speer



An Equal Opportunity Employer M/F/D

Report to Gordon C. Duke, Secretary, Finance and Administration Cabinet
On the Results of an Investigation into
Allegations in the Auditor of Public Accounts' March 11, 2003 Letter
Concerning Proffered Personal Service Contract C-03036568
Between the Kentucky Racing Commission and Richard A. Sams

Introduction

In a March 11, 2003 letter to Brent Yonts, chair of the Government Contract Review Committee, and Gordon Duke, Secretary of the Finance and Administration Cabinet, State Auditor Edward Hatchett communicated the receipt of anonymous complaints regarding the subject contract. This brief report is the result of an investigation into the allegations contained in Mr. Hatchett's letter. The report discusses each allegation contained in Mr. Hatchett's letter and offers recommendations derived from the relevant facts.

Allegation number 1: "There was no Request for Proposal (RFP) for this contract. "Expertise," without elaboration, is the only reason cited as the basis for selection of the contractor.

Findings of Fact

- A January 31, 2003 memorandum from the Commission's Executive Director to the Secretary of the Cabinet explicitly requests an "... exemption of the solicitation process." The memorandum contains the following statements:
 - "Pursuant to KRS 230.215 the Racing Commission has deemed this contract necessary to ensure the proper administration of drugs and/or stimulants so as to protect the substantial public interest."
 - "The Commission has the responsibility for overseeing the equine drug research. Therefore, this contract is critical to the ongoing validation of pending equine research. Hence, it is necessary to contract for these services with someone more familiar with issues related to equine research."
- Item 6 of the Proof of Necessity indicates that no other providers were considered for the contract.
- The Racing Commission's Executive Director confirmed that no other providers were considered for the contract in a March 27, 2003 email to the Director of the Finance and Administration Cabinet's Division of Administrative Policy and Audit.
- Item 7 of the Proof of Necessity, Basis for Selection ... contains the single word, "Expertise."
- The proposed contract contains the following language in the Extended Description: "The Contractor shall perform equine drug testing, equine drug research and make recommendations to the Kentucky Racing Commission regarding drug testing and enforcement...."

Report to Gordon C. Duke, Secretary, Finance and Administration Cabinet
On the Results of an Investigation into
Allegations in the Auditor of Public Accounts' March 11, 2003 Letter
Concerning Proffered Personal Service Contract C-03036568
Between the Kentucky Racing Commission and Richard A. Sams

- KRS45A permits exemptions from the solicitation process only in instances of emergency or when there is clearly only one source from which to obtain the good or service.
- The Racing Commission had a contract with Iowa State for "equine drug testing services," which expired on June 30, 2002.
- The Racing Commission paid the University of Kentucky's College of Agriculture \$243,500 for "equine drug research" on Procurement Desktop Invoice number I-03036568.

Allegation number 2: "The contract asserts that state personnel cannot perform this work. The Maxwell H. Gluck Equine Research Center at the University of Kentucky (Gluck Center) is under contract to perform equine drug research and testing for the Commission."

Findings of Fact

- According to the applicable web pages, the Gluck Equine Research Center is a component of the Department of Veterinary Science of the College of Agriculture of the University of Kentucky.
- An exhaustive search of Procurement Desktop contract header and line data in the Management Reporting Database yielded no evidence of the existence of the alleged contract.
- However, the Racing Commission did pay the College of Agriculture \$243,500 for "equine drug research." The payment was made on February 5, 2003 via Procurement Desktop Invoice number I-03042347.

Allegation number 3: "The language of the 'Extended Description' of the work to be performed is vague and specifies no identifiable work product."

Findings of Fact

- The contract's extended description contains the following language:
The contractor shall perform equine drug testing, equine drug research and make recommendations to the Kentucky Racing Commission regarding drug testing and enforcement. The contract shall begin on September 01, 2002 and end June 30, 2003 with renewal as needed.

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- The description of work to be performed in the Proof of Necessity contains the same language.
- The Scope of Services contains the same language.
- Nothing in the contract explicitly describes the types of drug testing to be performed, the nature of the drug research to be carried out, nor the topics/issues/questions to be addressed by the recommendations.

Allegation number 4: "The Racing Commission's approval of this contract in September 2002 was for \$25,000. In January 2003, the Commission voted to increase the contract to \$50,000."

Findings of Fact

- A January 28, 2003 letter from the Secretary of the Cabinet to the Racing Commission's Executive Director discusses a "... contract with a racing chemist of national reknown..." that the Racing Commission authorized "last fall." This letter mentions a not to exceed amount of \$50,000; however, no \$25,000 amount is mentioned.
- According to KRS 45A, whether the contract is for \$25,000 or \$50,000 is irrelevant to the requirement for a Request for Proposals (i.e., solicitation process).

Allegation number 5: "The unit price of \$125 per hour is excessive when compared to rates charged in existing arrangements with the Gluck Center for equine drug testing and research."

Findings of Fact

- An exhaustive search of Procurement Desktop contract header and line data in the Management Reporting Database yielded no evidence of the existence of a contract between the Racing Commission and the Gluck Center.
- The theory of soliciting competitive bids is that the marketplace will yield the optimum combination of price and quality of product or service.
- The previously mentioned contract with Iowa State University provided for unit prices: (1) urine samples at \$66.30 and (2) blood samples at \$12.50.
- As stated above, no other providers were considered for this contract.

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Allegation number 6: "The contractor is Richard A. Sams, PhD. A complainant alleged to us that Dr. Sams does not have a private laboratory in which the tests and research could be conducted, but instead will use the facilities of Ohio State University where he is an employee. The complainant asks, 'Should Ohio State University be a party to the contract.'"

Findings of Fact

- The proposed contract is between the Racing Commission and Dr. Sams.
- Any arrangements Dr. Sams may have made for laboratory facilities are between Dr. Sams and the provider of the facilities.
- Personal services contracting statutes and policies do not require contracting agencies to insist that prospective contractors disclose their arrangements for rendering the service. Whether such disclosures should be required is left to the prudence of the contracting agency.

Allegation number 8: "The Horsemen's Benevolent and Protective Association, Ohio Division, Inc. (HBPA) filed a written complaint with the Ohio State Racing Commission in December 2002 regarding the failure of the Ohio State University equine laboratory to complete routine drug testing in a timely manner. Results, which should have been available in less than a week, were, according to the letter sent by HBPA, taking three and four months to complete. Dr. Sams is a Professor and the Laboratory Director of the Ohio State University Analytical Toxicology Laboratory, which is responsible for this testing.

Findings of Fact:

- The proposed contract's terms do not contain any criteria for timely return of test results.
- The proposed contract is between the Racing Commission and Dr. Sams; Ohio State University is not a party to the contract.

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Conclusions and Recommendations

The materials in this Cabinet's possession relevant to this contract clearly permit the following conclusions:

- No other potential providers were considered for the needed service (as documented by the Proof of Necessity and the Racing Commission Executive Director's March 27 email);
- The description of the work and work products desired is too vague to have permitted other potentially interested providers to have indicated how much they would charge for the needed service;
- The proposed contract is open-ended as evidenced by the "with renewal as needed" language. This indicates that its ultimate cost could be anticipated to exceed its current \$50,000 total;
- As evidenced by the Racing Commission's payment, the University of Kentucky's College of Agriculture is capable of performing "equine drug research;"
- As evidenced by the contract that expired on June 30, 2002, Iowa State University is capable of performing "equine drug testing;" and
- Other potential providers may also be capable of providing the needed service as evidenced by the fact that other providers were considered for the contract awarded to Iowa State University.

In view of these conclusions, the Kentucky Racing Commission should:

- In keeping with the requirements of KRS 45A, develop a sufficiently clear description of the service and work products required that it is possible to determine whether state personnel can meet the need. Inquiries should be made of the various state universities at a minimum.
- If it is determined that state personnel cannot perform the required service, incorporate the description into a Request for Proposals and advertise appropriately. In view of the fact that Iowa State University, the University of California at Davis and Truesdail Laboratories, Inc., responded to the advertisement for the Equine Drug Research contract won by Iowa State, the advertisement should be circulated widely enough to ensure that potentially competent providers will have an opportunity to see it.

KENTUCKY RACING COMMISSION'S RESPONSE TO AUDITOR'S REPORT

The Racing Commission's response is presented in black type. Auditor's reply is presented in italicized blue type.

KENTUCKY RACING COMMISSION'S
RESPONSE TO
REPORT
OF
EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS
COMMONWEALTH OF KENTUCKY

PREFACE

The Kentucky Racing Commission (the 'Racing Commission') appreciates the Auditor's recognition of its and its staff's "...cooperation during this examination." The Racing Commission believes that the office of Auditor of Public Accounts performs an important purpose and service to the citizens of Kentucky and its effective work enables the citizens of Kentucky to better understand and appreciate the complexities of their government as well as the efforts that are undertaken to provide an efficient and cost effective government for Kentucky's citizens.

RACING COMMISSION'S
COMMENTS
REGARDING AUDITOR'S
FINDINGS & RECOMMENDATIONS

*[Auditor's Findings](#)
Cost of Executive
Director is an
unnecessary expense
for the Backside
Commission, see
page 3.*

1. Cost of Executive Director of the Backside Commission

a. Auditor's Findings

The Auditor's Report indicates that the salary of the extant Executive Director of the Backside Commission is \$66,916 annually and with fringe benefits approaches nearly \$80,000 annually. The Report has concluded this position should be 'abolished' and that a Racing Commission employee should administer the Backside Fund with the actual time spent by the Racing Commission employee being charged to the Fund, with an anticipated result in the saving of "...at least \$50,000 annually."

b. Racing Commission's Comment

1. The Racing Commission appreciates this recommendation and it will be reviewed, thoroughly, as the Racing Commission proceeds to fulfill its statutory responsibilities.

2. The Auditor's Report accurately indicates that this position has not been staffed full-time and the full salary has not been absorbed. However, in view of the publicity that has surrounded this portion of the Auditor's examination, the Racing Commission believes that it is noteworthy to expand upon the Auditor's finding, to-wit that "The Executive Director's leave balances were depleted and she charged over 2,000 hours to leave-without-pay over the last four years. The Commission deemed the leave to be necessary and gave approvals, accordingly."

The inclusion of the sentence "The Commission deemed the leave to be necessary and gave approvals, accordingly." (as used in the Auditor's Report) leaves an unfortunate implication that the Racing Commission permitted this individual to not attend her work and that this individual might have been 'sloughing off' -- either and both of which would be of concern to a citizen/taxpayer of Kentucky.

The Racing Commission feels that it would have been more accurate if such an incorrect 'implication' had been more fully explained in two particular instances:

- a. As the Auditor has been fully advised, this individual has experienced serious health problems over the previous four years. Those health problems have involved extensive surgeries, which under existing federal statutes that protect this individual's health privacy rights, cannot be further explained.
- b. Secondly, due to this employee's continuing health problems, the Racing Commission must be cognizant of the possibility that its removal of this Executive Director's position, during such employee's health impairment, could subject the Racing Commission and the

State to litigation asserting violation/s/ of state and/or federal statutes designed to protect the rights of ill and infirmed employees. In such an event, there could be extensive additional resources (financial/time) required to defend the Racing Commission's decision.

3. While there may well be an issue about whether the Executive Director's position is necessary from a financial standpoint, the public should not be allowed to perceive, by implication, that this particular person was 'sloughing off' in her duties, or that federal statutes permitted the Racing Commission to abolish the position of a person with extensive health problems without subjecting the Racing Commission and the State to federal litigation.

Auditor's Reply: By focusing on the leave-without-pay matter, the Racing Commission is ignoring the salient point of the comment – that there simply is not enough work associated with the administration of the Backside Commission to justify a full-time employee. Our report states that the Executive Director's leave was approved by the Racing Commission. We do not presume that the Racing Commission would approve leave for an employee to simply 'slough off' and we recognize the legitimate need for the leave to be taken. The leave-without-pay resulted in direct savings to the Backside Commission, a savings that could be greatly increased by abolishing this unnecessary position altogether.

Auditor's Findings
The Racing Commission hired two principal assistants through positions established in the Backside Commission, see page 5.

2. **Funding of Racing Commission employees through the Fund**
 - a. **Auditor's Findings**

The Auditor's Report has found that funds have been transferred from the Racing Commission to the Backside Fund for the purposes of the employment to two principal assistants; and that this procedure should cease. The Auditor's Draft Report concludes, correctly, that the Racing Commission routinely reimbursed the Fund; therefore, any implication that there was a depletion of monies would be unfounded.

b. Racing Commission's Comment

1. The Racing Commission appreciates the Auditor's recommendation and it will be reviewed, thoroughly, as the Racing Commission proceeds to fulfill its statutory responsibilities. While the Racing Commission desires to fully and properly attend to its statutorily-mandated duties, it most certainly has an equal intention to do so in the most fiscally-conservative manner, consistent with the fulfillment of those duties and obligations.

*Auditor's Findings
The purchase and distribution of Racing Commission pins should be restricted; passes should be discontinued, see page 5.*

3. Purchase of Racing Commission Pins and the issuance of passes

a. Auditor's Findings

The Auditor's Report has recommended that Racing Commission pins should be restricted and the issuance of passes should be discontinued.

b. Racing Commission's Comment

1. The Racing Commission agrees with the Auditor's finding regarding the Racing Commission pins. Further, in view of the extensive press examination of this issue, it is deemed important that the Auditor's Report noted facts in his report which reflected that long before his examination began, the Racing Commission had already pro-actively undertaken the effort to reduce the distribution of such pins. The aggregate order of pins for 2003 (based on vendor minimums) was 332 of which only 178 were actually distributed. The Auditor has found that the remaining 154 pins were not distributed and were fully accounted for at the Racing Commission. Lastly, the Auditor's Report found no impropriety in the distribution of the pins. Thus, it is believed that the present Racing Commission has taken control and security steps to prevent issuance abuse of these pins.

2. Further, regarding the ‘pins’, the Racing Commission will continue its several year policy of reducing the number of pins distributed and the enhancement of security measures for their issuance.
3. Regarding the ‘passes’ and other credentials, there is some concern about whether the relinquishment of this authority will present problems for the Commission’s licensed individuals and might, in some measure, result in a lessening of the Commission’s authority over its licensees. The Racing Commission is very appreciative of the Auditor’s recommendation and it will be thoroughly reviewed.

Auditor’s Reply: The Racing Commission is claiming some type of relationship between giving away passes and its authority over licensees. License holders currently receive pass privileges by merely possessing a license. The passes are obsolete, pose a risk for abuse, and should be eliminated.

Auditor’s Findings
*Commissioners
Special Account
should be privately
maintained and solely
used for private
purchases, see
page 7.*

4. Use of Commissioner’s Special Account

a. Auditor’s Findings

The Auditor’s Report has recommended that the Commissioner’s Special Account, comprised solely from the Racing Commissioner’s expense reimbursement checks, should be limited to “...tokens of acknowledgement or other concerns of a private, non-official nature.”

b. Racing Commission’s Comment

1. Historically, the Commissioner’s of the Racing Commission have returned their expense reimbursement checks to a Special Account which has been used for pins, julep cups for Derby trainers, funeral flowers for deceased racing dignitaries, etc. Historically, such an account has been deemed to be advisable so the Racing Commission could express its respect for and honor of participants in the racing industry.

2. Henceforth, the Racing Commission shall not ask its Commissioner's to contribute to this Special Account; and the Racing Commission's Executive Director has been asked to refund the remaining balance in this account to the Commissioner's, on a *pro rata* basis and close the account.

*[Auditor's Findings](#)
Racing Commission
requires strict
adherence to
Administrative
Regulations over
claiming races, see
page 9.*

5. Claiming Issue

a. Auditor's Findings

The Auditor's Report has recommended the Racing Commission "...reinforce its efforts to educate potential claimants of the statutory requirements and to assure the availability of assistance from stewards or a clerk of claims" and revise its claim form to avoid inadvertent spelling errors by claimants and permitting the claimant to 'check-off- the applicable track name, rather than spell it out, themselves.

b. Racing Commission's Comment

1. The Auditor's Report indicates that its concern about the Racing Commission's claiming forms was "...brought to our [its] attention...." and it was further brought to the Auditor's attention that the Racing Commission's practice of rigidly enforcing the accuracy of a claim form was costing "...the state thousands of dollars in sales taxes that would otherwise be collected on valid claim sales." The Auditor has found that the Stewards void about six claims per month.
2. The Racing Commission believes that every responsible licensed owner is aware of the 'rigid' requirement of total accuracy, in every respect, when he or she completes a claim form. The Racing Commission believes that while its requirement of rigidity may cost some sales tax receipts, it results in far greater savings in litigation expenses that would necessarily follow from a more lax system of claiming horses. The Racing Commission believes that laxity breeds carelessness on the part of claimants, which breeds further and unnecessary confusion.

- a. As an aside, the Racing Commission's counsel recalls a case where the claimant had improperly filled out a claim form. At the Commission Hearing to contest the issue, the claimant, without an attorney, was advised that if he won the 'point', he would have to buy the horse and was then asked if he really wanted the horse that he had improperly claimed -- the answer was 'no'. This set of events is noted as *indicia* of the confusion that would be created by conforming to a more lax procedure.

Upon the usage of all present claim forms, the Racing Commission agrees to consider the revising of its claim forms.

Auditor's Reply: We recognize, agree with, and applaud the Commission's rationale for strict claiming procedures. Our recommendations are made in an attempt to ensure tax dollars are not lost due to claims voided as a result of inadvertent errors.

*Auditor's Findings
Proposed Racing
Commission personal
service contract found
deficient by the
Finance and
Administration
Cabinet, see page 9.*

6. Personal Service Contract of Dr. Sams

a. Auditor's Findings

The Auditor's Report has reviewed the effort to award a personal service contract to Richard A. Sams, DVM, and determined that in the future R.F.P.'s should be developed which sufficiently describe the work requested so as to enable existing state personnel and state universities to have an opportunity to bid. Further, the Auditor's Report includes as an addendum the Finance & Administration Cabinet's findings, to-wit that the Racing Commission should interview candidates for the position of Internal Policy Analyst to serve the Racing Commission.

b. Racing Commission's Comment

1. Sometimes a 'little history' is helpful when considering an issue.

One of the biggest problems facing America's racing industry is the question of the proper drug/medication policy for horses involved in parimutual wagering. In view of the drug-related issues surrounding the 1968 Kentucky Derby,

the Racing Commission firmly believes that a same or similar situation (at this point in history with 24-hour news programming) could devastate the racing industry, nationally -- and one of the largest industries in Kentucky. In September, 2002 Kentucky's Equine Drug Council ('Drug Council') was insistent that Dr. Richard A. Sams, DVM ('Dr. Sams') be employed to assist in drug/medication policy evaluation and testing. The Drug Council had concluded that Dr. Sams was *the* recognized national expert in the field and felt that his involvement with Kentucky's drug/medication program was most advisable and critical.

While it's highly possible that the Racing Commission's zeal to be an industry leader in this critical area caused it to act too quickly, which resulted in an unfortunate issue about the methods used to implement Dr. Sams' contract -- the reasons for the zeal and the quality of the individual involved must be taken into some consideration.

2. The Racing Commission agrees with the Finance & Administration Cabinet's finding and is implementing their recommendations.

Additionally, the Racing Commission is implementing the recommendation of the Finance & Administration Cabinet by arranging, within its budget, to employ an Internal Policy Analyst, with a financial background, which will enable it to more effectively operate.

